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SUBJECT: INDONESIA -- OUTLOOK FOR PRESIDENT YUDHOYONO'S
SECOND TERM

REF: JAKARTA 1160 AND PREVIOUS

Classified By: Ambassador Cameron R. Hume, reasons 1.4(b+d).

11. (C) SUMMARY: President Yudhoyono's decisive victory in Indonesia's recent presidential election gave him a second five-year term and a strong mandate to govern. He will need a stable Parliamentary coalition and a strong Cabinet to implement his reform agenda, however, and neither of these is assured. He has committed himself to greater institutional reforms, combating corruption, and spurring economic growth, particularly through infrastructure investment. Yudhoyono will work to raise the country's international profile and implement a moderate foreign policy. For the U.S., Yudhoyono's victory is a positive--he is someone we can work with as we try to consolidate our Comprehensive Partnership.
END SUMMARY.

A BIG VICTORY

12. (C) On July 8, Indonesian voters affirmed President Yudhoyono's record over the past five years and gave him a landslide victory with a clear mandate (reftel A). Yudhoyono promised he would use that mandate over the next five years to complete his reform program. Under his leadership, Indonesia rolled back the threat of terrorism and brought peace to Aceh. Indonesia's economy has weathered the global financial crisis largely due to sound economic management and is on track to grow nearly 4% this year. President Yudhoyono is looking to solidify his legacy on the international stage. He will also need to make further progress on his domestic agenda: combating corruption, instituting bureaucratic reform, and building Indonesia's infrastructure.

UNFINISHED REFORM AGENDA

13. (C) President Yudhoyono won by running on his record--promoting good governance, managing the global economic crisis, and prosecuting corrupters. His actual performance record on governance issues is mixed. While some strides were made, there is unfinished business in implementing decentralization and bureaucratic reform. Decentralization, although popular across Indonesia, has resulted in uneven local government performance across the country. Yudhoyono's initial efforts at bureaucratic reform have not yielded much except in ministries under strong cabinet leadership. Many believe Vice President Jusuf Kalla and his Golkar party--recently defeated in the presidential race--were obstacles to reform.

14. (C) Yudhoyono has made moderate progress on his

anti-corruption agenda. With its success in prosecuting high-level government officials, the Corruption Eradication Commission has developed strong opposition. The Corruption Eradication Commission faces resistance from Parliament, the police, and other government actors. The arrest of the former Corruption Eradication Commission chair has placed the institution in a precarious position. Continued anti-corruption reform will be an important variable in Yudhoyono's ability to attract foreign investment and promote good governance.

STABLE COALITION, STRONG CABINET VITAL

15. (C) Yudhoyono's cabinet will be critical to implementing his domestic agenda. With a strong mandate and his Partai Demokrat as the largest political party in Parliament, Yudhoyono has less of a need now to placate rival political parties by awarding cabinet positions. He will still need a coalition in Parliament to govern, so doling out some Cabinet posts is likely. The choice of Boediono (one name only), a technocrat without party affiliation, as a vice presidential running mate could be a preview of how Yudhoyono will choose his cabinet. Yudhoyono said in a July 6 Wall Street Journal interview that he will appoint a "technocratic" team. The cabinet team Yudhoyono assembled during his first term hindered his reform agenda, and even non-rival party cabinet appointments were difficult for Yudhoyono to manage. To ensure greater coalition discipline in his next administration, Yudhoyono has called for a political contract--essentially, an oath of loyalty--for all coalition members and cabinet picks. Despite this, Yudhoyono may find

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his cabinet unwieldy.

16. (C) Parliament could remain an obstacle to passing the president's agenda. Although the President's Partai Demokrat is the largest single party, holding roughly 20-25% of seats in the legislature, the parliament's consensus-based style will demand a strong coalition to pass laws. While Partai Demokrat's presidential coalition included the four Islamic parties that will have seats in Parliament plus other parties, this may not be sufficient to drive legislation. Although Boediono is a well-regarded technocrat, he does not possess the political savvy of Jusuf Kalla, who was an effective inside political operator. During his first term, Yudhoyono was reticent to assert himself with Parliament, preferring a consensus building approach. President Yudhoyono--who is quite cautious in style--has pledged to be more decisive in a second term, but he will still need to build a stable parliamentary coalition to drive his agenda forward.

ECONOMIC OUTLOOK

17. (C) President Yudhoyono's re-election bid was due largely to Indonesia's strong economic performance during the global financial crisis--third best growth rate in Asia (and the G-20) in the first quarter of 2009. The poverty rate is lower (14.2% in 2009, 16.7% in 2004); debt-to-GDP ratio has declined (33% in 2009, 57% in 2004); and per capita income has doubled to \$2,237 during Yudhoyono's first term. However, Yudhoyono's record of economic reform is mixed, largely due to the vested interests and mixed performance in his Cabinet. Yudhoyono made improvements to the investment law, but investment obstacles remain, particularly the need to reform the labor law. Legal certainty improved, but the judicial system is still widely viewed as corrupt. Vice President (to be) Boediono is expected to bolster the reformers in Yudhoyono's cabinet, providing a commitment to sound economic policy and a steady voice for reform.

18. (C) Infrastructure investment, reforming the labor law, and improving legal certainty remain as critical challenges for Yudhoyono in order to improve the foreign investment climate, increase growth, and raise incomes. Despite a drop

in the official poverty rate, nearly 50% of Indonesians live on less than \$2 per day. Economic policy options will remain limited for the coming years, however, due to fiscal constraints and uncertain coalitions in Parliament. Yudhoyono will continue to contend with economic nationalist sentiments in Parliament.

¶9. (C) Yudhoyono pledged to double infrastructure spending to \$140 billion over the next five years. Labor law reform is a political hot button and Yudhoyono shied away from any commitments on this front during the campaign. Anti-corruption reform efforts and resolution of high-profile cases (e.g., TIME-Suharto libel case, APP-Oaktree/Gramercy, Intel trademark case) have inspired some increasing confidence. Yudhoyono's first big test in his second administration will likely be the future of the Anti-Corruption Court, whose extension requires government action (legislation or a temporary presidential decree) by December.

¶10. (C) Yudhoyono's choices for his economic team are likely to determine the pace of reform. The anticipated move of Sri Mulyani Indrawati--Yudhoyono's leading reform champion--to head the Central Bank will be a blow to reform implementation as she will have a narrower range of influence there. Yudhoyono's Parliamentary coalition with Islamic parties will likely support institutional reforms (e.g., anti-corruption reform and bureaucratic reform), but is apt to waver on market-oriented reforms (e.g., energy policy and subsidies, labor law). If Golkar joins a coalition under the potential party leadership of Aburizal Bakrie, Yudhoyono may face further threats to his economic reform agenda from vested interests. For instance, a coalition which contains a Bakrie-led Golkar is unlikely to resolve the continuing Lapindo mudflow disaster caused by one of Bakrie's many firms.

FOREIGN POLICY PROSPECTS -- POSITIVE FOR U.S.

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¶11. (C) As more of a big-picture thinker than a workhorse, Yudhoyono may leave the domestic reform agenda to the experts in his cabinet. This will give Yudhoyono the freedom to pursue a greater international agenda. Yudhoyono is looking to establish his legacy through his second term and many contacts suggest that fully bringing Indonesia to the world's stage will be a key part of this legacy. Indonesia's participation in the G-20 is changing the way the country views itself, from a regional leader only to a regional leader with global reach. Yudhoyono achieved considerable success in resolving the situation in Aceh, easing one of the internal constraints on Indonesia's ability to provide leadership. Now, some of Yudhoyono's ability to bring his global ambitions to fruition in the eyes of many in the international community will depend on his ability to bring peace and stability to Papua, a region plagued with separatist movements, internal violence, and limited institutional capacity.

¶12. (C) For the U.S., Yudhoyono's victory is a positive--he is someone we can work with as we try to consolidate our Comprehensive Partnership. Building such a partnership in turn supports Yudhoyono's strategy for Indonesia to gain more international prestige, and exercise greater influence on climate change, regional security, and international economic issues. The U.S. needs to move forward in engaging Indonesia on key issues of concern, including Burma, North Korea and Iran. To move from a healthy, middle-tier relationship to a genuine partnership with Indonesia, we will need sustained high-level Washington attention, including visits, to demonstrate our commitment to advancing that partnership.

HUME